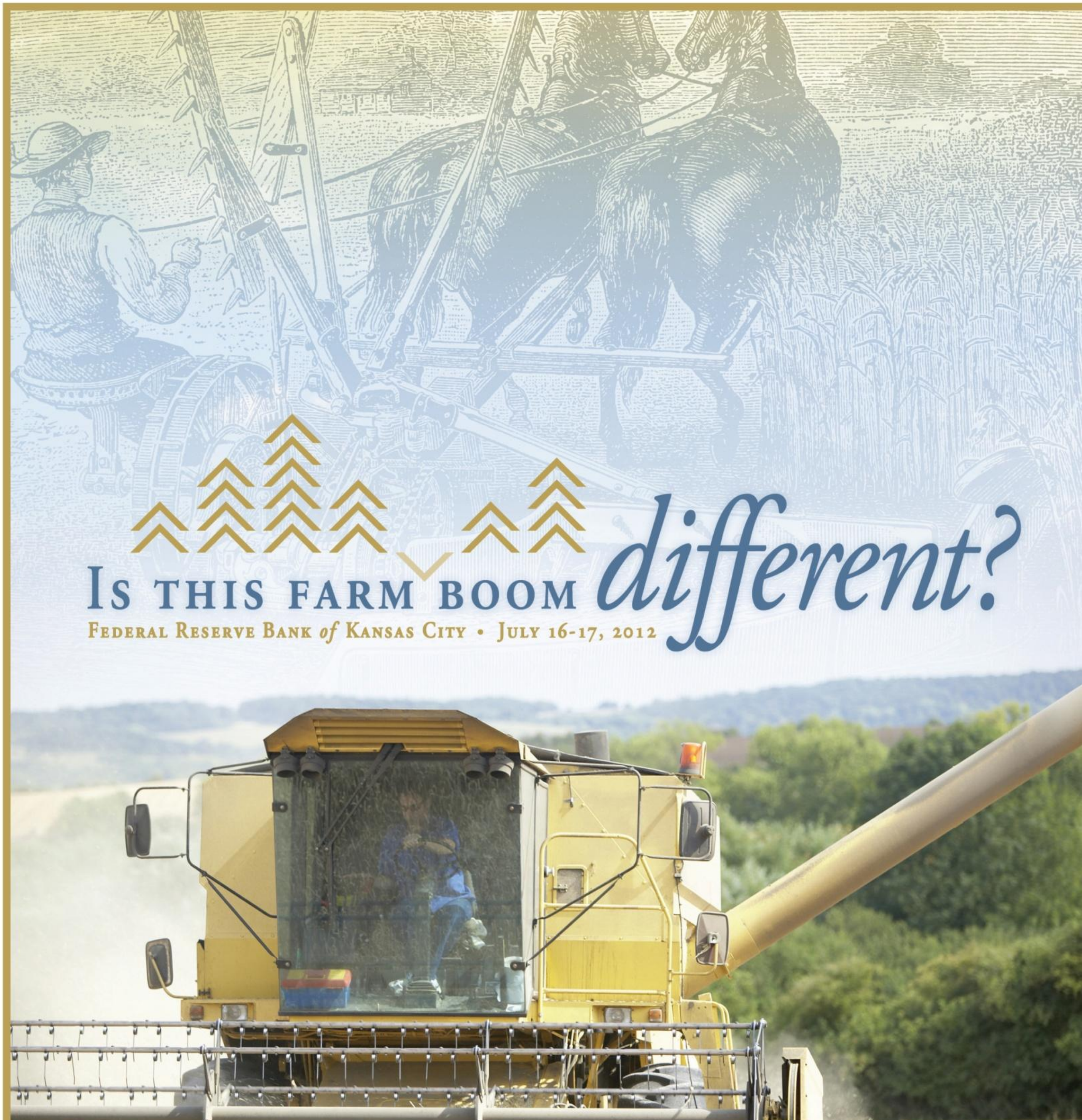

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Dinner Speaker:
Macroeconomics and Agriculture

Macroeconomic and Agriculture (Remarks)

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Let me extend my welcome to all of you and thank you for joining us for this ag conference and symposium. For the speakers who have dedicated this chunk of time, I thought today's sessions were very important and illuminating on a number of issues that certainly intersect with monetary policy.

One of the strengths that I've always thought comes from the regional structure of the Federal Reserve System is the opportunity that it affords a policymaker to interact with the public. Whether that is my travels through our seven-state region to talk with business leaders, to talk with bankers, or to have the opportunity to participate in a session like this is extremely valuable. It helps ground policy, I think, in some of the real issues that affect our economy today. Even though you might look at the ag sector in the United States and say, "Well as other sectors have expanded, it has become a smaller portion of this country's GDP."

There is no question that the ag sector remains an important element of the U.S. economy. And certainly in this part of the country, and for this region in particular, it has been important to the Federal Reserve Bank of Kansas City.

As Paul [DeBruce] mentioned, I am a member of the Federal Open Market Committee. And, in a couple of week, I will attend our next meeting in Washington. At that meeting, I will join with 11 other regional Reserve Bank presidents, who will offer their views on what's happening in their regions and assimilate those views with the seven members of the Board of Governors in Washington, as we decide on issues of monetary policy for the country.

The discussions that will come from this program today and tomorrow will be important pieces of information in my analysis and how I shape my views on what's happening in this region and how the impact of monetary policy is affecting the issues here. So understanding what is happening in the ag sector is particularly relevant, I think, to monetary policy.

As Paul [DeBruce] mentioned, I am connected to the farm sector. My parents live on a farm about an hour north of here. Yesterday, I drove up there to take a look at how the corn and soybeans were faring in this dry weather. I stopped by the house to see how my 91-year-old father was doing, and he's always interested in what part of the country I'll be in or what I'm doing. So I mentioned today's program and the title of it, "Is This Farm Boom Different?" He was quite amused at the title.

He said, "I know, with your Cracker Jack economists, there is probably something different about this one." But he said, "I can assure you when it comes time to mop up, it's going to feel just the same." [laughter]

And, frankly, having been a bank examiner in this region in the 1980s, I supervised banks that felt the full brunt of that decade's crisis. As many of you know, banks by the hundreds failed in this part of the country, as a boom in agriculture, in real estate, and in energy came to a really devastating end.

Now, with the benefit of hindsight, we know that investors and bankers mispriced the riskiness of the assets in those sectors. The result was it took years for this region to recover from that.

So the question and title of this conference, which is "Is This Farm Boom Different?" is particularly important. It has important considerations for monetary policy and for financial stability in the United States.

I want to thank, in particular, Brent Gloy for his presentation today. I thought that was an excellent presentation on farmland values and the influence of low interest rates. I pulled out a copy of a slide you had, which was "The Relationship Between Current Farmland Values and Expected Corn Prices." It's the one that had the dots all over and you said if you drew a line, you could put a bubble in there.

Many of you may know that the Federal Open Market Committee participants are now submitting their projections for their forecast of the economy. There are no names attached. It is just a bunch of dots on the page. I made note on that slide that you characterize it as a red flag. I'll keep that in mind for our next FOMC forecasting.

Let me turn to the purpose of my remarks this evening. I am going to say a few things about the state of the U.S. economy and briefly make some comments about the importance of confidence to a strong economy in the United States. After that, I would be happy to open the floor to any questions, comments, or observations you have. Then we'll turn it back over to Jason [Henderson] to adjourn for the evening.

Regardless of what you hear on CNBC or other media outlets, the U.S. economy is growing. It is growing slowly for sure and some might even characterize it as growing a bit erratically over the last three years we have been in recovery. On several occasions over this past three years, we've seen spurts of growth, only to be disappointed by some slow patches in that recovery. And it looks like this summer's slowdown is going to be no exception to that. So the economy grows and then we slip back for various reasons.

Of course, as you know, households form the core of this economy in the United States. And households have been increasing their spending at a moderate rate of growth. We've seen a surge in automobile purchases, for example, that came after some of the disruptions from the issues in Japan with the earthquake and tsunami.

Those levels of purchases have leveled off a bit, but remain at a positive level. And we've gotten more recent data on broader measures of retail spending, which look like they have cooled a bit this summer.

Of course, we know that one very important factor that is weighing on household spending right now is the labor market. The unemployment rate, although it has fallen noticeably over the last year, remains well over 8 percent and that is too high at this point to generate the kind of spending we would normally expect to see. So monthly payroll gains, as we saw last month at around 80,000, are not robust enough yet at this point to generate the kind of growth we would want to see in the economy. This tepid pace we see in the labor market reflects a very cautious business sector right now in the country.

We saw initially in the recovery robust spending around equipment and software, as businesses began to make, what I call, productivity investments after laying off people. But that also has slowed recently. And nonfinancial businesses, we know, have sharply increased their cash holdings at this point, reflecting I think some of the considerable caution we see on behalf of businesses.

In fact, as I travel around our seven-state region, it is a pretty common report from businesses in this sector that they are concerned about uncertainty. They are not ready to make investments. They are not ready to hire yet at this point until some of that uncertainty clears. So whether it is conditions in Europe, whether it is the regulatory landscape, or whether it is issues around the fiscal situation in this country, businesses have decided to hold tight at this point in terms of their own spending.

The picture in the housing market is getting more encouraging, as we look at the data. This has been long overdue, but finally we are beginning to see home prices stabilize, the demand for housing is gradually picking up, and certainly the fundamentals around a growing population, increases in the number of households, low interest rates, and -- as we begin to see more improvement in the labor markets -- I expect that will continue. These should generate more demand for construction in the single-family sector and certainly we are seeing fairly robust demand in the multifamily sector of the economy right now.

As the recovery begins to take hold and we begin to see some of this uncertainty fade, I suspect we will continue to see improvement in the economy as a whole. I don't think we'll see growth in the economy much beyond 2 percent for the year. But, again, as some of this uncertainty begins to clear, for the road ahead for some of these out years you will begin to see the economy pick up.

I want to talk a little bit, though, about the importance of confidence in the U.S. economy, because as I said there are many factors that you hear today from businesses and from households that have lost trillions of dollars of wealth from this recession that cause the economy to be growing at the slow pace it is. Certainly, we continue to hear about Europe. We continue to hear about issues of the fiscal cliff, which cause people concern. Issues around regulatory issues around small businesses I hear frequently.

But there is another issue we see increasingly in today's headlines that affects confidence in this country. It has to do with questions of integrity in the financial sector. We know the health of the U.S. economy depends on a strong financial sector in the United States. When I think about the banking system -- the financial sector -- I think of it a bit as the heart, if you will, of the circulatory system in this country, which takes capital from savers and moves it to borrowers who then decide where they will allocate the uses of that credit in this country.

To that end, since the financial panics and since the recession, the United States has been focused on particularly strengthening that financial sector, through capital injections through the TARP program, through mandating, and through regulations that the industry increase its levels of capital and begin to put some reforms in place. And you have seen over the last three years that the banking system on a whole has begun to improve.

But the public's confidence in the stability of our financial system depends on more than the rules we legislate. It depends more than on the levels of capital those institutions hold. At the end of the day, confidence in the banking system really rests on the public's trust of these institutions and their conduct of ethical standards of business as they carry out their very important role. Unfortunately, that trust which was already badly damaged from the events of 2008-09 is being further undermined by the recent barrage of headlines that talk about investigations related to energy market manipulation, interest rate manipulations, anti-money laundering issues, misconduct, and in some cases, poor risk management related to significant trading operations. All of this affects the public's trust in these institutions.

In fact, last week an organization called Rasmussen conducted a national survey. They asked people whether they had confidence in the stability of the U.S. financial sector. For the first time, more than half of the people surveyed said they lacked confidence in the financial system in the United States. That's a serious issue for our economy and for its ability to respond to the challenges it has.

The question becomes, What will it take to restore that confidence? Are people just mad at big banks and aren't going to cut them any slack? I suppose that's the case and frankly I think that is with some justification. Because if you think about the nature of the U.S. economy, a market-based capitalistic system, we expect success will be rewarded and we expect failure will also be recognized with loss.

So most people understand that, if you are a small bank, you will fail if you don't make the market test. And they also understand that some banks in the past crisis were considered "too big to fail." The ability of the country to restore accountability for the issues we face now and to ensure the incentives for risk taking are equitable across the entire banking system are going to be key to restoring confidence not only in the banking system and in the financial sector of this country, but for the long-term strength of the U.S. economy that will be critical.

I am going to stop at this point, because you've had a long afternoon, but I would be delighted to take your questions, your comments, your observations, or frankly any advice you want to offer me at this point. So I am going to stop and I will be happy to entertain your questions from the floor. [applause]

____________: Esther, I think one of the great confidence restorers would be if you could talk to your counterparts in the Department of Justice and speed up the prosecution of those who are apparently doing bad things. MF Global, the big banks, and now we have a case in Cedar Falls, Iowa of Peregrine Financial. These just keep growing. I know personally if I mess up on my tax return, the IRS is on my case within about six months. I am waiting for Jon Corzine and a few others to come before the public and face their day.

Esther George: I'll take that as a comment. Well taken. Thank you. Please.

Larry Dreiling, *High Plains Journal*: My question runs to the strength of the overall economy, not so much in our neck of the woods, because the district here is rather strong. But the rest of the nation, as you mentioned, seems to be one piece of bad news after another as it comes from Wall Street. Let's jump to January. If you were seated at that FOMC meeting and had a vote today, would you go for another round of quantitative easing or not? [laughter]

Esther George: Well, let's see. It's the end of July and a lot can happen between now and then. I can't tell you today how I would vote in January, because as we know the data move quickly and – depending on the circumstances – I could not stand here and say I know what I'm going to do at that point.

At the heart of the question you're asking, Given the issues that trouble the economy today, can they be resolved with monetary policy? That is the real challenge for my colleagues and me, as we sit around the table and talk about these issues. If you look at where we are today, we have provided a highly accommodative stance of monetary policy. We have been at zero interest rates for going on four years. The Committee's last statement projected that it might stay at these rates until late 2014.

The FOMC has made decisions about buying assets. We have a balance sheet that is $3 trillion, compared with $900 billion going into the financial crisis. So my observations at this point are we have a tremendously accommodative policy for the economy to begin the process of recovery. It has progressed well through recovery.

Will monetary policy put people back to work at this point? That's not clear to me. So I think, as we calibrate monetary policy, we have to understand both the risk that comes with the policy stance we have today and to watch to see what is the nature of how the economy moves going forward. And when I get to January, you'll read in the papers where I come out on that. Thank you.

Steve Jordon, *Omaha World-Herald*: You mentioned "too big to fail" or too big to do something [laughter]. I guess I might ask what your thought is on that idea. As you know, your predecessor had some opinions on it. To coin a phrase, do you think that "too big to fail" has failed?

Esther George: I will tell you that we know because we had a real-life experiment, if you will, in 2008-2009. We know there were some institutions that were too big to fail. Legislation has been put in place, which offers us a legal framework for resolution of these institutions. But, at this point, we have not completed the process of writing those rules nor have we had a situation where we had to test those rules. What we know is those institutions are larger than they were in 2008. We know today they benefit from a subsidy that most banks in this country do not have the advantage of and that is the markets believe they are still too big to fail. That carries an advantage to them in terms of their ratings and in terms of their funding cost.

My conclusion would be that we still have work to do to address the issue of "too big to fail" in the United States and it will take very committed regulators and policymakers to make sure we move forward with addressing that if we are going to restore both confidence in this financial system, as well as its strength for the long term. [applause]

Anyone else? I know you have more advice for me. [laughter]

_________________: …a little bit about inflation and talk about what your policy would be if inflation kicks in ….

Esther George: The question is about inflation and where inflation is going and the comment about how quickly it can emerge.

You see the same data I do, whether you are looking at core or headline inflation, you know inflation remains low. If you look at long-term expectations for inflation, they remain relatively low. The Federal Reserve earlier this year set an inflation target of 2 percent to use as its guide for keeping price stability in the economy.

I would agree. Near term, I hear people say there is no evidence of inflation. But we know from past periods, that inflation doesn't give you a lot of advance notice. We know conditions are extremely easy right now in terms of monetary policy and in terms of the amount of liquidity that is setting on balance sheets. It would be the Federal Reserve's intention at the point it begins to see upward pressure on inflation to consider that, but that is always the central bankers' concern, and it is something I keep an eye. You don't want inflation to get ahead of you. Watching how long-term inflation is being manifested is going to be very important, as the economy moves through its recovery.

Doug Wareham, Kansas Bankers Association: Thank you for a wonderful meeting, President George. I actually met with a member of Congress – and I know there is a number of media in the room, so I'm not going to mention who it is – but I specifically asked about the deadline on the tax policy at the federal level. The comment I received, which gave me chills, was, "We really hope in January to do some type of a one-year extension." You and your fellow presidents, looking at tax policy and the deadlines and the major battle we will be seeing in the next few months, please comment on that and your concern -- especially with agriculture and estate planning -- how that might affect a number of people in this room.

Esther George: The fiscal issues that face the United States are no secret and neither is the solution. It is pretty straightforward when you look at what the issue is, which is we are spending more than we take in, and the long-term trajectory of the debt in our country is only going to rise when the demands placed on that from an aging population and the health care that comes along with that, given the entitlement programs we have in place today.

However you look at this issue, the arithmetic is simple that something has to be done. The sooner it is done, the more manageable it is to implement the changes that will be required so we don't derail a recovery that is not yet robust by any measure. Taking action today gives us time to look to the long term and gives us time to think about the adjustments that need to be made for the long-term health of the economy. It is my hope steps will be taken sooner rather than later. I'm not naïve. I understand this is an election year, so that makes things harder to do. But the sooner we get on that, the better it will be for the long-term health of this economy.

Alan Brugler, Brugler Marketing & Management: This is a follow-up to your previous statement, but related to Europe.

We hear a lot about – as I call it – the crisis that keeps on giving. Obviously the Europeans are dealing with several of these same issues. And, if you could, address what we are learning from them. Also, please address how the Fed approaches the contagion issue.

Esther George: You've hit on two issues that relate to the situation in Europe. The contagion issue, of course, is one that we experienced in 2008-2009. That is, when market players lose confidence and when they don't see what the exposures are of their counterparty, you can transmit panic, if you will, through that channel. So that is a risk.

Europe, of course, has a more fundamental issue they are dealing with. It is not one we have in the United States, which is we have a fiscal union at this point. Europe, of course, is wrestling with the fact they have put a monetary union in place, but they do not have underlying that the ability to draw on the resources of individual sovereign countries. That is at the heart of the challenge they face.

Is that something that can be dealt with in a meeting or two? That's unlikely, given their history. This will take time to work through. We have seen progress made in thinking about the banking sector and the issues that have to be addressed in dealing with their financial system, but it seems to me a long-term proposition to deal with something as fundamental as linking yourselves for a fiscal union. So that will be essential as they move forward and that, I expect, is going to be an issue we'll see for some time that will create some kind of uncertainty for the U.S. economy.

Well, I want to thank all of you again. I am very much looking forward to our discussions tomorrow. I thank you for participating in this event. [applause]